Europe in 1992

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With the approach of the 1990s, the world is witnessing a remarkable conjuncture of movements toward economic integration, movements aimed at tearing down barriers to commerce both within and between nations. Within nations, deregulation or liberalization of markets has been widespread in recent years. Between nations, the recent U.S.-Canada Free Trade Agreement, the emerging European common market, and the Uruguay Round of Multilateral Trade Negotiations seem likely to further the economic integration of vast areas if not the world economy.

The focus of this article is on the European Community internal market. The 12 member nations of the EC (European Community) are now striving to realize the full promise of the 1957 Treaty of Rome (the European Economic Community's founding charter), which called for a Community-wide market free of restrictions over the movement of goods, services, persons, and capital, and for progressively "approximating," or harmonizing, the economic policies of the member states. Much progress toward these goals has been made. By July 1, 1968, a customs union had been established among the original six members of the EC, as France, Germany, Italy, Belgium, the Netherlands, and Luxembourg had abolished tariffs on trade among themselves and had imposed a common tariff schedule on imports from other countries. Subsequently, Denmark, Ireland, the United Kingdom, Greece, Spain, and Portugal have joined the union.

Not only have EC members formed a customs union, but they have taken some noteworthy steps toward approximating their economic policies. For example, a Common Agricultural Policy was adopted in 1962. And the establishment of the European Monetary System in 1979 was a significant move toward monetary integration, as most of the member countries undertook to limit fluctuations in exchange rates between their currencies to rather narrow, publicly announced ranges.

Although the EC states have approximated some of their economic policies and have achieved a customs union, they have yet to complete the next stage of economic integration—the common market. A detailed program for attaining this stage was set forth by the EC Commission (the EC's executive body) in June 1985 in a White Paper entitled, "Completing the Internal Market." The EC Council (the EC's supreme decisionmaking body) promptly committed the EC to carry out the White Paper's program by the end of 1992.

The White Paper lists 300 specific areas (subsequently reduced to 279) for action by 1992. The proposed actions are intended to eliminate the obstacles to an integrated market, which the Paper divides into three kinds of barriers—physical, technical, and fiscal. A genuine European Community, without internal economic frontiers, is the desired result, with freedom of movement for goods, services, persons, and capital.

What has sparked this renewed drive toward economic integration within the EC? What might be the consequences, not only for the EC but for the rest of the world, and particularly for U.S. business?

Why a Common Market?

Between the formation of the customs union in 1968 and the adoption of the White Paper in 1985, little progress was made toward a common market in the EC. The hostile economic climate of the 1970s—with the oil shocks of 1973–74 and 1978–79, the high inflation rates, and the recessions—led the member country governments to focus more on protecting their constituencies from external forces than on dismantling economic barriers. What, then, revitalized the process of economic integration?

One factor has been the improvement in EC economic conditions during the 1980s. Another stimulus has been mounting frustration with the obstacles to intra-EC transactions. For example (Calingaert 1988, pp. 6–7):

> As members of the European Community Youth Orchestra traveled within the Community, they had to carry documentary evidence of their instruments' country of origin and often had to deposit the value of their instruments when leaving their home country to satisfy customs authorities that they had not exported the instruments.
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> A European television manufacturer had to make seven types of television sets to meet member country standards, which required 70 engineers to adjust new models to individual country requirements and cost an additional $20 million per year.

Another motivation for further integration is to rectify the EC's slow growth and high unemployment, a condition partly traceable to structural rigidities that has been labelled "Euro-sclerosis." This particular motivation has been heightened by anxiety that the EC is becoming less competitive in the world economy and is lagging behind Japan and the United States in economic performance. Establishment of a common market is seen as a tonic that will enhance efficiency, largely by promoting competition within the EC and by fostering the development of production facilities large enough to achieve the economies associated with large-scale production.

The prospect of substantial gains has fired the imagination of EC officials and of many other Europeans. To convey their enthusiasm, it is worth quoting a few paragraphs from *A Frontier-Free Europe*, a publication of the Commission (1988b, pp. 8–9, 16–17).

> This tremendous challenge is galvanizing Europeans as no other has done over the last four decades. Everyone has more or less accepted the ugly truth that continued inertia will lead the member countries of the Community into inexorable international decline. . . .
>
> Yesterday the Twelve were manifestly apathetic, unassertive and disunited. . . . They had failed once again to take the Community's birth certificate—unity is strength—to its logical conclusion. . . . With 'Deadline 1992' the hour of resurgence has come. In an appointment with history, the European Community is gambling on the ability of Europeans to rise to a challenge, on that spirit which, down the centuries, has made them great on the international scene. . . .
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> . . . the large frontier-free market can make a vital contribution to the recovery and competitiveness of industry and commerce and act as a motive force for European union. . . .
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> Support for integration . . . is no longer confined to dreamers and old-fashioned romantics. It is coming from pragmatic Europeans, confronted day in day out with the absurdity of 12 national markets every bit as compartmentalized as they were in medieval times. . . .

Establishment of a common market is seen as a tonic that will enhance efficiency in economic performance.

> The need to create a market comparable with that of the United States is obvious. . . . Our present structure of nation-States is costing us enormous sums of money and making it easier for our competitors to divide and rule. Europe is now trailing the U.S. and Japan in key areas of high technology. We must pool our efforts to narrow the gap.

In the same vein, another EC publication prophesies, "After the 'American challenge' of the 1960's and the subsequent emergence of Japan onto the world stage, the 1990's promise to be the decade of a revitalized Europe" (Commission of the European Communities: Spokesman's Service, p. 10).

Is this just empty rhetoric? Or are the potential gains truly large, and is the EC really mobilizing to achieve them? And what barriers must be removed in order to complete the internal market?

Completing the Market: Barriers That Must Go

The barriers targeted for removal by the White Paper can be divided into eight categories, some of which overlap.[1]

(1) *Border controls.* At the borders between EC member states are physical controls that regulate the passage of people and goods. Such controls are necessitated by certain differences in laws and regulations between member states. For example, widely differing indirect tax rates (including excise and value-added rates) require tax adjustments at the borders to ensure that goods crossing over are taxed at the rates of the countries they are entering, so as to minimize competitive distortions. Differing health regulations for plant and animal products also require controls to ensure that such products satisfy the regulations of the country the products are entering. These controls impose significant delays and other costs. Harmonization of the differing laws and regulations (including tax rates) would of course be one way to obviate the need for such controls.

(2) *Limitations on movement of people and their right of establishment.* An important illustration of this kind of barrier is that academic degrees and professional qualifications acquired in one EC member country have not, as a rule, been readily recognized in other member countries. Thus, it has been difficult for professionals to transfer the practice of their occupations from one state to another. In addition, border controls are maintained to combat terrorism, drug trafficking, and illegal immigration by non-EC residents.

(3) *Differing indirect taxation regimes.* As already noted, the existence of differing tax rates and systems is one reason for the maintenance of border controls. Thus, the EC Commission has proposed that the same excise tax rates should be adopted by all EC countries and that value-added tax rates should diverge by no more than 5 to 6 percentage points between countries, a divergence that the Commission believes would be essentially neutral in its effect (Calingaert 1988, pp. 42–43).

(4) *Lack of a common legal framework for business.* The operation of business enterprises in the EC has been governed largely by differing national laws and regulations, introducing complications into cross-border business activity involving mergers, joint ventures, patents, copyrights, and so forth.

(5) *Controls on movement of capital.* Eight of the EC states have maintained some degree of control over capital movements to or from other member states.

(6) *Heavy—and differing—regulation of services.* The service industries, such as transportation and especially finance, have been subjected to regulation that has considerably raised the cost of the services provided and that has also differed significantly from one member state to the next.

(7) *Divergent product regulations and standards.* Often a product has had to meet differing standards in different EC countries.

(8) *Protectionist public procurement policies.* In procuring goods and services, the public authorities in the various EC countries have generally granted preferential treatment to domestic suppliers in a number of ways, including the procedures through which bids are solicited and contracts are awarded.

These eight categories of barriers comprise a formidable phalanx. It is not surprising that substantial gains from their removal are forecasted by a recent study.

The Potential Gains: Some Quantitative Estimates

In order to obtain quantitative estimates of the economic benefits that could flow from the common market, the EC Commission arranged for a major study, the results of which were published only last year. A massive research effort, the study involved 200 people, took two years to complete, and cost about $5 million. It is the only comprehensive analysis available of the potential gains to the EC from completing the internal market. Carried out under the general direction of Paolo Cecchini, a former EC Commission official, the study is summarized in a slim volume widely known as the "Cecchini report" (Cecchini 1988).

In the study the potential gains to the EC from market integration are evaluated using both microeconomic analysis, which focuses on the effects on producers and consumers, and macroeconomic analysis, which focuses on the effects on major components of the gross domestic product (GDP). With both analytical approaches, the starting point is the removal of the market-fragmenting barriers targeted in the White Paper. Their removal will lower the costs of doing business—a favorable supply-side shock—and prices are expected to go down with costs under the pressure of wider competition across the newly unified market. The reduction in prices will stimulate demand and, therefore, output, and the increase in output will lead to further reductions in costs as economies of larger-scale production are realized.

In the microeconomic analysis, two approaches are employed: a price-convergence approach and a welfare-gains approach. The price-convergence approach assumes that the removal of barriers will greatly reduce the substantial price differences often observed for a given product between EC countries. Across countries in 1985, the average before-tax price variation from the EC mean price was 15.2 percent for consumer goods and 12.4 percent for capital equipment. Much greater price dispersion was observed for some individual items, such as glass and crockery (21 percent), boilermaking equipment (22 percent), tea (27 percent), ladies' linen and hosiery (31 percent), and books (49 percent). And glaring price differences (tax inclusive) are reported within the service sector: 28 percent in road and rail transport, 42 percent in electrical repairs, and 50 percent in telephone and telegraph services.

As barriers to arbitrage across countries are relaxed, prices should converge, and intensified competition across frontiers should lower the general average. Thus, the analysis assumes that in sectors where barriers are currently low, any price peaks will be brought down to the EC average, and that in sectors with high barriers, prices will settle at the average of the prices prevailing in the two EC countries with the lowest price levels. On the further assumption that output remains unchanged, this line of analysis concludes that total savings from the drop in prices would be about 4.8 percent of EC gross domestic product—a one-time, once-and-for-all gain.

This gain estimated by the price-convergence approach is conservative in that it takes no account o (1) the increases in output that would accompany th increased demand stimulated by price reductions o (2) the further cost- and price-reducing effects of larg er scale production. By contrast, the welfare-gains ap proach does allow for these ramifications. It is mor comprehensive than the price-convergence approacl in another respect as well: it takes into account th profit losses that may be suffered by some currentl protected producers as well as the gains to consumer and other producers. In the welfare-gains approach, gain for consumers (or "consumer surplus") stem from lower prices and larger purchases, and this gai is partly offset by a drop in profit for producers sub jected to new competition. Another gain, with no of setting losses, results from enhanced operationa efficiencies throughout the EC.[2]

Table 1 itemizes the net welfare gains estimate by this approach. "Barriers directly affecting intra-E trade" are essentially customs formalities and relate delays. "Barriers to production" are those that im pede entry into a national market by a foreign firm Among such production barriers are the preferentia treatment granted by government purchasing office to native producers, differing national regulator practices, and differing national standards for prod ucts. The estimated maximum gain, nearly 6.5 pe cent of GDP, is substantially larger than the 4. percent of GDP estimated with the price-convergenc

Table 1
Potential Gains in Economic Welfare for the European Community Resulting from Completion of the Internal Market

Source of Gain	Gain as Percentage of GDP
1. Removal of barriers directly affecting intra-EC trade	.2 to .3
2. Removal of barriers to production	2.0 to 2.4
3. Greater economies of scale, and intensified competition reducing inefficiencies and monopoly profits	2.1 to 3.7
Total	4.3 to 6.4

Source: Paolo Cecchini, *The European Challenge: 1992*, p. 84.

Table 2
Estimated Medium-Term Macroeconomic Consequences for the European Community from Market Integration Processes

Nature of Consequence	Process: Removal of Customs Formalities	Opening of Public Procurement	Liberalization of Financial Services	Supply-side Effects	Total: Average Value	Spread
Change in GDP (%)	.4	.5	1.5	2.1	4.5	3.2 to 5.7
Change in Consumer Prices (%)	−1.0	−1.4	−1.4	−2.3	−6.1	−4.5 to −7.7
Change in Employment (thousands)	200	350	400	850	1,800	1,300 to 2,300
Change in Budgetary Balance (percentage point of GDP)	.2	.3	1.1	.6	2.2	1.5 to 3.0
Change in External Balance (percentage point of GDP)	.2	.1	.3	.4	1.0	.7 to 1.3

Source: Paolo Cecchini, *The European Challenge: 1992*, p. 98.

approach; but even the 6.5 percent figure might be too low, since it does not allow for the impact of new business strategies and technical innovation that could be stimulated by integration of the market.

Shifting from the microeconomic to the macroeconomic perspective, the study's analysis of potential gains from market integration focuses on the major components of GDP. As can be seen in table 2, the macroeconomic analysis proceeded by quantifying the effects of easing barriers in customs procedures, in public procurement, and in financial services, and by quantifying various supply-side effects entailing greater business efficiency. The greatest gains are estimated from the liberalization of financial services and from supply-side effects.

The gains from liberalizing financial services stem from the resulting intensification of competition and associated reduction in the prices of financial services. Transmission of lower financial services costs throughout the economy is estimated to reduce prices generally, stimulating demand (both domestic and external) and output. This favorable effect will be amplified by increased investment in response to the lower cost of credit. More general supply-side effects come from the business sector's response to the more competitive environment—from more efficient techniques and greater economies of scale.

In total, the macroeconomic consequences of EC market integration are expected to be very favorable. It is estimated that GDP will be boosted by 4.5 percent, with 1.8 million new jobs, while consumer prices will simultaneously be lowered by 6.1 percent. The aggregate government budget balance is expected to improve by an amount equivalent to 2.2 percentage points of GDP, as government revenues rise with GDP and procurement costs are eased with the opening of public procurement to wider competition. Benefiting from improved competitiveness, the EC's current-account balance with the rest of the world is estimated to improve by the equivalent of 1 percentage point of GDP. Again, these are one-time, or once-and-for-all, gains, and their realization is likely to require 5 or 6 years once the market-integration program is complete.

The nature of these gains—especially the drop in consumer prices and the improvements in public finances and the external balance—suggests that still greater gains might be achieved were EC governments to pursue more expansionary fiscal policies. Thus, policies that reduced the improvement in government budget balances to 0.7 of a percentage point of GDP might boost the medium-term increase in GDP to 7 percent, with 5 million new jobs and no inflation, according to the Cecchini report (pp. 99–102).

As the basic study makes clear, such gains are contingent on removal of all essential barriers to market integration. Retention of only a few key barriers would suffice to restrain competition. In the words of the study, "Implementation of half of the actions proposed in the White Paper will deliver much less than half of the total potential benefits" (Commission of the European Communities 1988a, p. 22).

With such sizable total gains in prospect, the question arises how the gains will be distributed among the EC member countries. The study offers no quantitative estimates of this distribution. Economic theory suggests that proportionately larger gains will accrue to the smaller countries, especially those that have recently joined the EC and have had relatively high protection from external competition. Initially, however, such countries could suffer losses, as could various regions within the EC, until the firms and workers exposed to keener competition made adjustments such as adopting new techniques or acquiring new skills. Should some EC members suffer losses from the integration process, the EC has policy instruments, such as structural funds, that could be used to help them recover (Commission of the European Communities 1988a, p. 21).

Potential Gains for Countries Outside the EC

If market integration does yield the growth spurt projected for the EC in the Cecchini report, rising EC income could lead to increased imports and thus to higher levels of economic activity in the rest of the world. The boost to GDP in the rest of the world would be considerably smaller than that inside the EC, however, and like that within the EC, would be a one-time phenomenon. Indeed, the net impact on the rest of the world could be contractionary, since the Cecchini report expects the rest of the world to experience a deterioration in its trade balance with the EC unless EC governments pursue relatively expansionary macroeconomic policies.

EC market integration could lead to higher levels of economic activity in the rest of the world.

Another potentially favorable result for the rest of the world is a lower rate of inflation, induced by the projected deflationary impact of EC market integration. This, in turn, could lead to lower interest rates if inflationary expectations were revised downward. And the rest of the world would experience more favorable terms of trade with the EC, if the real cost of goods purchased from the EC went down. This outcome, too, is far from certain. The expected growth spurt in the EC could generate an investment boom, pushing interest rates upward rather than downward and raising rather than lowering the real cost of goods exported from the EC in the near term. In this case, though, economic growth in the rest of the world could receive a larger boost, as the EC's external trade balance would likely deteriorate.

Still another gain for the rest of the world is possible, although it is even more speculative and imponderable than the preceding gains. As we have noted, one motivation underlying EC market integration is to narrow a perceived lag in EC economic performance behind Japan and the United States. Such competition among nations, if conducted without protectionist devices, can benefit all involved. Perhaps the United States, for example, will be spurred by the European challenge, as it has been by the Japanese challenge, to reconsider and improve some of its ways of doing business.

The Specter of Fortress Europe

As the foregoing discussion suggests, the consequences of EC market integration for the rest of the world are highly problematic, even on the assumption that the EC completes its internal market without resorting to intensified protection against the rest of the world. Now suppose that as the EC allows the winds of competition to blow more freely across its members' frontiers, it simultaneously erects substantially more barriers against competition from the rest of the world, so as to mitigate the overall competitive shock and the degree of internal adjustment that will be required. This outcome, which is rather widely feared, would have damaging consequences for the rest of the world, and perhaps for the EC as well.

Were the EC to turn inward in this way, international economic cooperation in general would surely be undermined. For example, efforts to coordinate macroeconomic policies among the EC, Japan, and the United States would probably suffer. More certainly, the Uruguay Round of Multilateral Trade Negotiations, undertaken to liberalize international trade in both goods and services, would be imperiled if the EC's protectionist course became manifest before the completion of the Round, now scheduled for 1990.

A heightening of the EC's protectionist barriers would tend to negate the benefits that could otherwise accrue to the EC itself from integrating its internal market. After all, realization of those benefits is deemed to depend heavily upon a widening of competition within the market. Insofar as the strengthening of internal competition is offset by the blockage of competition from abroad, the benefits will be choked off near the source.

Were the EC to erect more barriers against outside competition, the consequences could be damaging for the rest of the world and perhaps for the EC as well.

If completion of the internal market in this fashion would yield little benefit for the EC, the rest of the world would benefit even less, and might well be harmed. For example, intensification of EC protectionism would militate against the reduction of costs and inflation within the EC and thus would do little to lower inflation abroad. Other countries might also experience a worsening of the terms on which they traded with the EC, as EC demand for their goods and services was damped by the heightened barriers, although this outcome would depend on the circumstances, including the nature of the barriers and the foreign response to them.

If protectionism were to transform the EC into "Fortress Europe" as it completed its internal market, how might the transformation occur? What measures would work the transformation? Because internal market integration implies removal of barriers between EC member countries but not necessarily between the EC and other countries, EC members might typically agree that all should impose against other countries the harshest of the barriers currently prevailing in any EC member country, while simultaneously eliminating such barriers against movements of goods, services, people, or capital among themselves.

To illustrate, the individual states of the EC currently maintain as many as 1,000 separate quantitative restrictions on imports (including the so-called "voluntary" restraints that some countries impose on their exports to EC countries), mostly on imports from Japan, the Asian newly industrialized countries, and the East European nonmarket economies (Calingaert 1988, p. 83). To prevent imports in excess of any restriction that it has promulgated, each EC country must monitor the flow of the restricted goods that comes to it via other EC members as well as from other sources. However, such border controls over intra-EC trade, with the associated delays and other costs, are inconsistent with EC market integration. To eliminate the border controls and complete the internal market, therefore, EC members must abolish the restrictions or establish a uniform set, to be applied by all the members acting as one, on imports from the rest of the world.

The most important of these restrictions relate to textiles and automobiles. For both of these commodity categories, it is likely that uniform EC restrictions will replace the prevailing individual member restrictions, resulting in no less overall protection than that now in force. Exports from the United States in these two categories are currently exempt from the restrictions, but automobiles from the United States might be covered in the future. Now it is automobiles from Japan that are targeted. If Japanese-brand automobiles manufactured in the United States were to be exported to the EC in sizable volume, the EC surely would consider encompassing them within the restrictions (Calingaert 1988, pp. 83–84).

Of even greater concern for the United States is the possibility of another variety of EC protectionism. This protectionism would take the form of denying "national treatment" for U.S. firms seeking to enter the EC through subsidiaries. The principle of national treatment—meaning government treatment of foreign-owned subsidiaries that is no less favorable than that accorded domestically owned firms—has been endorsed by all 24 member countries of the Organization for Economic Cooperation and Development, including the EC countries. But some EC officials and documents have espoused a different principle, the principle of reciprocity. Under a strict interpretation of reciprocity, subsidiaries to be established in the Community by firms located in a nonmember country would be granted the benefits of the integrated market only if EC subsidiaries in that nonmember country enjoyed similar benefits.

Some measure of reciprocity has been called for in proposed EC directives on financial services, especially with respect to investment services and life insurance, and also to some extent with respect to banking. In regard to banking, it would not be possible for the United States to offer to EC banks opportunities comparable to those that EC banks have in their home markets. U.S. laws and regulations do not permit banks, either domestically or foreign-owned, to establish branches or subsidiaries nationwide, and banks in the United States are also subjected to other restrictions—for example, on securities activities—that do not apply to banks in the EC. (What the United States can and does offer is national treatment, or equality of competitive opportunity for banks regardless of nationality of ownership.) Thus, a strict interpretation of reciprocity could put U.S. banks at a competitive disadvantage in the Community.

The principle of reciprocity could be applied by the EC within certain sectors such as banking, or could be applied on an overall basis, with the EC granting national treatment in sectors such as banking in return for new opportunities for EC firms abroad in other sectors. The overall approach would be more consistent with the traditional practice in multilateral trade liberalization, in which the negotiating parties generally settle for an overall balance of concessions rather than a balance sector by sector. For the EC to demand sector-by-sector reciprocity as it integrated its internal market would be especially inimical to the achievement of a more liberal international economic order.

Rather than explicitly denying national treatment to foreign firms, the EC might engage in roughly equivalent practices, the effect of which would be protectionist even if the motivation were not. For example, the set of regulations and product standards to be adopted by the EC as part of the integration process could render foreign firms less competitive in the EC market. The purpose of EC regulations and standards is generally to assure some minimum quality, and concerning that general goal there can be little dispute. But if EC authorities refused to recognize product tests administered abroad, foreign manufacturers would face the expense of shipping their products to the EC for testing and sale without the assurance of certification.

Aside from difficulties with the certification process, non-EC firms could be disadvantaged by the EC standards themselves. A good illustration is the controversy between the EC and the United States over U.S. meat produced with the aid of growth hormones. Growth hormones are widely used in meat production in the United States, but not in the EC. The EC recently banned imports of such meat for human consumption on the grounds that it poses health hazard. Arguing that scientific inquiry revea no hazard, the United States has retaliated with 1(percent duties on selected U.S. imports of EC foo products whose total import value approximates th $100 million of banned U.S. meat exports.

The Likelihood of Fortress Europe

It is much easier to conjure up the specter of Fo tress Europe than to determine whether the Fortre: will materialize. What is the likelihood that the E will become more protectionist as it completes its i ternal market?

In his classic, *The Customs Union Issue*, Jacc Viner opined that "with respect to most custon union projects the protectionist is right and the fre trader is wrong in regarding the project as somethin given his premises, which he can logically suppor (Viner 1950, p. 41). Viner believed that the extern barriers of the typical customs union would be adjus ed so as to offset—indeed, more than offset—ar overall decline in protection associated with heigh ened competition among the members. It would t hard to prove that the EC has followed such a prote tionist course from its inception, particularly with r spect to tariffs on manufactured goods. With respe to other forms of protection the record is not so goo especially in recent years.

Moreover, some EC documents and official stat ments are worrisome. In July 1988, Willy de Clerc then the EC Commissioner for External Relations, a serted that the new common market will "give us th negotiating leverage to obtain . . .overall reciprocit (de Clercq 1988). Similarly, the Cecchini report warn "If the fruits of the European home market are to t shared internationally, there must also be a fair shar out of the burdens of global economic responsibilit with market opening measures extended internatio ally on a firm basis of clear reciprocity" (Cecchi 1988, p. xx). And the White Paper declares that "tl commercial identity of the Community must be co solidated so that our trading partners will not be gi en the benefit of a wider market without themselv making similar concessions" (Commission of the E ropean Communities 1985, para. 19). Not only w the EC seek global reciprocity (an overall balance concessions), but according to Mr. de Clercq, it w seek sectoral reciprocity in certain sectors not cover by the General Agreement on Tariffs and Trade, pa ticularly the services sector (de Clercq 1988).

Concern is warranted not only by such official pronouncements, but also by EC trade policy, which, as in some other countries, has turned more protectionist and discriminatory over the past two decades. Much of the heightened protection and discrimination has taken the form of various nontariff interventions. In particular, the EC has made increasing use of selective, quantitative import restrictions (including "voluntary" export restraint agreements), especially to limit manufactured imports from developing countries. In addition, it has subsidized EC exports, notably exports of agricultural goods whose production is also protected by variable import levies, and it has employed countervailing and antidumping duties more vigorously (Henderson 1989, pp. 13–14). In light of this seeming predisposition toward protectionism, it would not be surprising if competitive pressures generated by the removal of barriers to trade within the EC were eased by the elevation, or at least the maintenance, of similar barriers against competition from without. Thus, completion of the EC's internal market may well entail at least the preexisting degree of EC protection against foreign competition.

Any shift toward greater protection by the EC is likely to be slight, however, so that the specter of Fortress Europe will probably remain little more than a specter. As EC authorities are well aware, even minor heightenings of protectionist barriers have provoked retaliation from the injured trading partners, and the prospect of such retaliation is a strong deterrent. To put much the same point more positively, the EC, like most other trading entities, has much more to gain from an open, integrated international economy than from one fragmented by protectionist barriers. Indeed, that conclusion flows from the same line of reasoning that is used to justify the completion of the EC internal market. And the EC has many good logicians.

U.S. Business and the Common Market

U.S. business has a sizable stake in the EC. In 1988 the United States exported $130 billion in goods and services to the EC, one-third more than to Canada, our second largest export market. Because most export sales are of merchandise and because detailed

Table 3

U.S. Exports of Domestic and Foreign Merchandise to Canada and the European Community in Total and by Leading End-Use Categories, 1982 and 1988[a]

Millions of U.S. Dollars

Category[b]	Canada 1982	Canada 1988	European Community 1982	European Community 1988
Grand total	37,799	68,747	51,255	74,679
Total foods, feeds, and beverages	1,966	2,225	8,839	5,689
Agricultural foods, feeds, and beverages	1,801	1,994	8,653	5,561
Total industrial supplies and materials	9,054	12,615	16,650	19,734
Nonagricultural except fuels	6,361	10,043	9,648	14,463
Chemicals, excluding medicinals	1,979	3,170	3,648	6,019
Capital goods except automotive	10,173	16,547	19,628	36,997
Nonelectrical machinery, including parts and attachments	8,194	12,581	14,643	25,581
Industrial and service machinery	3,727	5,055	5,284	7,329
Computers, peripherals, and semi-conductors	1,335	3,853	4,926	12,080
Transportation equipment, except automotive	1,107	2,168	3,588	8,935
Civilian aircraft, parts and engines, excluding special category	925	1,915	3,124	8,434
Automotive vehicles, parts and engines	9,310	19,634	954	2,162
Passenger cars, new and used	2,345	6,266	76	643
Automotive parts, engines and bodies	6,211	10,585	778	1,364
Consumer goods (nonfood), except automotive	2,141	3,452	3,872	7,228
Domestic exports, n.e.c., and reexports	5,156	14,271	1,312	2,680

[a] Special category military-type goods are not included.
[b] Categories shown are those in which total exports to Canada and the EC were $5 billion or more in 1988.
Source: National Institutes of Health, COMPRO data base.

data are available on the merchandise categories, tables 3 and 4 present statistics for the leading merchandise categories. The data are shown for Canada as well as the EC, not only because Canada is the second largest U.S. export market but because the two nations have recently concluded a free trade agreement.

As shown in the tables, for merchandise alone, total EC and Canadian purchases of U.S. exports were not vastly different in 1988. However, except for automotive vehicles, parts, and engines—in which sectoral free trade between Canada and the United States has contributed to close integration of the national industries—the EC is a much more important export market for the United States in every merchandise category listed in the tables. Especially noteworthy are the EC shares of U.S. worldwide exports in the categories of computers, peripherals, and semiconductors, and of civilian aircraft, parts, and engines (table 4).

Firms invade foreign markets not only by exporting but by acquiring facilities in those markets. Thus, U.S. multinational firms have many affiliates, including branches and subsidiaries, in Canada and the EC, and the sales of these affiliates are much larger than U.S. exports to either area, especially in the case of the EC (table 5). While not all such sales are to Canadian or EC residents, the preponderance surely are.[3] Between 1982 and 1986 (the latest year for which data are available at this writing), the biggest increases in these affiliate sales were in manufacturing industries, although the increase within wholesale trade in the EC also merits mention.

As can be seen in table 6, the EC affiliates of U.S. firms account for almost half of the sales of all foreign affiliates of U.S. companies. In nearly every industry listed the EC is significantly more important for these sales than Canada is. A comparison of tables 6 and 4 suggests that the EC absorbs a much larger share of these total affiliate sales than of total U.S. merchandise exports.[4] These phenomena may well be heightened by the completion of the EC internal market and the implementation of the free trade agreement between Canada and the United States. The EC internal market will probably serve to raise U.S. direct investment and sales within the market relative to U.S. ex-

Table 4
U.S. Merchandise Exports to Canada and the European Community in Total and by Leading End-Use Categories, as a Percentage of U.S. Exports Worldwide by Category, 1982 and 1988[a]

	Canada		European Community	
Category[b]	1982	1988	1982	1988
Grand total	17.2	21.5	23.3	23.3
Total foods, feeds, and beverages	6.2	6.8	27.7	17.9
Agricultural foods, feeds, and beverages	5.9	6.6	28.2	18.4
Total industrial supplies and materials	14.6	14.5	26.8	22.7
Nonagricultural except fuels	16.5	15.6	25.1	22.5
Chemicals, excluding medicinals	12.6	12.4	23.3	23.6
Capital goods except automotive	13.5	14.3	26.1	32.0
Nonelectrical machinery, including parts and attachments	14.7	15.2	26.2	31.0
Industrial and service machinery	16.4	17.9	23.2	26.0
Computers, peripherals, and semi-conductors	10.7	12.0	39.5	37.5
Transportation equipment, except automotive	9.2	9.6	29.7	39.7
Civilian aircraft, parts and engines, excluding special category	9.4	9.2	31.8	40.7
Automotive vehicles, parts and engines	58.3	61.2	6.0	7.1
Passenger cars, new and used	74.5	69.3	2.4	7.1
Automotive parts, engines and bodies	60.2	61.2	7.5	7.9
Consumer goods (nonfood), except automotive	13.7	13.4	24.7	28.0
Domestic exports, n.e.c., and reexports	56.6	60.4	14.4	11.3

[a] Special category military-type goods are not included.
[b] Categories shown are those in which total exports to Canada and the EC were $5 billion or more in 1988.
Source: National Institutes of Health, COMPRO data base.

Table 5

Sales of Canadian and European Community Affiliates of U.S. Multinational Companies, by Selected Industries, 1982 and 1986

Millions of U.S. Dollars

Industry[a]	Canadian Affiliates		EC Affiliates[b]	
	1982	1986	1982	1986
All industries	120,327	132,594	370,542	430,377
Petroleum	28,642	18,479	104,685	74,118
Oil and gas extraction	d	d	d	12,048
Crude petroleum (no refining) and gas	d	d	9,918	11,233
Petroleum and coal products	19,046	d	63,138	44,228
Integrated refining and extraction	17,233	10,640	35,128	18,841
Refining without extraction	d	d	27,796	25,275
Petroleum wholesale trade	3,645	2,178	23,023	11,553
Manufacturing	56,911	75,521	160,609	226,068
Food and kindred products	5,258	5,655	16,337	23,998
Grain mill and bakery products	1,214	1,465	6,454	9,990
Chemicals and allied products	8,265	10,493	30,451	40,705
Industrial chemicals and synthetics	4,240	4,638	13,791	18,289
Drugs	1,122	1,521	6,583	10,395
Primary and fabricated metals	3,202	3,880	9,284	12,232
Fabricated metal products	2,155	2,575	6,586	7,917
Machinery, except electrical	4,994	5,615	28,416	47,924
Electric and electronic equipment	4,323	4,704	11,928	24,174
Transportation equipment	19,108	34,075	36,867	36,760
Motor vehicles and equipment	18,086	32,383	d	35,036
Other manufacturing	11,761	11,099	27,325	40,274
Tobacco manufactures	d	d	d	10,648
Instruments and related products	1,079	1,024	8,602	10,482
Wholesale trade	9,788	10,984	58,645	75,460
Durable goods	7,001	8,315	36,935	43,013
Nondurable goods	2,788	2,670	21,711	32,447
Finance (except banking), insurance and real estate	6,349	7,499	8,361	11,888
Insurance	4,629	5,600	d	6,410
Services	2,403	2,611	9,413	15,520
Business services	810	966	5,387	9,850
Other industries	16,234.	17,499	28,829	27,323
Transportation, communication and public utilities	d	2,349	d	18,884
Retail trade	10,530	12,399	7,189	5,978

[a] Identifiable industries in which Canadian and EC affiliate sales totaled $10 billion or more in 1986.
[b] EC includes 10 countries because data for Spain and Portugal are not available.
d: Data were suppressed for confidentiality reasons.
Source: U.S. Bureau of Economic Analysis, *U.S. Direct Investment Abroad: Preliminary 1986 Estimates*, June 1988, table 7; and *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data*, December 1985, p. 112.

ports to it, because market completion plans call for a reduction in barriers to commerce within the EC but not between the EC and other countries. By contrast, the U.S.-Canada free trade agreement mandates the removal or reduction of many barriers to trade between the two nations.

What firms will benefit most from EC market integration? In general, the prime beneficiaries will be those firms that are highly competitive within the EC and that face substantial cross-border and other costs and barriers associated with EC market fragmentation. The lowering of these internal barriers and costs will enable such firms to compete more effectively across the Community. Should the EC maintain or elevate its barriers against external competition, these same firms will become even more profitable, at least in the short or medium term. Thus, it is understandable that the financial press has reported something of a scramble by firms to position themselves advantageously within the EC.

If completion of the EC internal market generates a growth spurt, as forecasted by the Cecchini report, EC demand for U.S. (and other) exports likely will also spurt, even if the EC maintains or slightly intensifies its protection against external competition. On the other hand, the Cecchini report expects EC firms to enjoy lower costs as a result of the market integration. Such enhanced competitiveness on the part of EC producers would enable them to accommodate some of the increase in EC demand that might otherwise generate U.S. exports. Similarly, U.S. firms would encounter stiffer competition from EC firms in

Table 6

Sales of Canadian and European Community Affiliates of U.S. Multinational Companies as a Percentage of U.S. Foreign Affiliate Sales Worldwide, by Selected Industries, 1982 and 1986

	Percent of Total Sales, All U.S. Foreign Affiliates			
	Canadian Affiliates		EC Affiliates[b]	
Industry[a]	1982	1986	1982	1986
All industries	12.9	14.2	39.6	46.2
Petroleum	8.7	9.2	31.8	37.1
Oil and gas extraction	d	d	d	30.5
Crude petroleum (no refining) and gas	d	d	19.6	32.0
Petroleum and coal products	14.0	d	46.4	52.0
Integrated refining and extraction	30.0	32.4	61.2	57.4
Refining without extraction	d	d	35.7	49.0
Petroleum wholesale trade	3.2	3.6	20.0	18.9
Manufacturing	15.8	16.8	44.7	50.2
Food and kindred products	13.5	12.7	41.9	53.9
Grain mill and bakery products	9.7	9.9	51.8	67.3
Chemicals and allied products	11.9	13.1	43.8	50.7
Industrial chemicals and synthetics	12.8	12.6	41.6	49.8
Drugs	8.6	8.4	50.2	57.5
Primary and fabricated metals	14.0	16.3	40.5	51.4
Fabricated metal products	16.1	18.3	49.1	56.2
Machinery, except electrical	10.8	7.9	61.2	67.3
Electric and electronic equipment	13.9	10.2	38.3	52.5
Transportation equipment	22.0	30.7	42.4	33.2
Motor vehicles and equipment	21.6	30.2	d	32.7
Other manufacturing	18.6	15.1	43.2	54.9
Tobacco manufactures	d	d	d	79.7
Instruments and related products	8.5	6.4	67.4	65.7
Wholesale trade	8.0	7.3	47.8	50.5
Durable goods	9.6	9.6	50.6	49.7
Nondurable goods	5.6	4.2	43.7	51.5
Finance (except banking), insurance and real estate	22.2	20.5	29.2	32.5
Insurance	27.6	26.6	d	30.4
Services	11.8	10.2	46.4	60.9
Business services	8.0	6.5	53.1	66.6
Other industries	21.4	25.2	38.0	39.4
Transportation, communication and public utilities	d	9.4	d	75.2
Retail trade	38.6	43.1	26.4	20.8

[a] Identifiable industries in which Canadian and EC affiliate sales totaled $10 billion or more in 1986.
[b] EC includes 10 countries because data for Spain and Portugal are not available.
d: Data were suppressed for confidentiality reasons.
Source: U.S. Bureau of Economic Analysis, *U.S. Direct Investment Abroad: Preliminary 1986 Estimates*, June 1988, table 7; and *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data*, December 1985, p. 112.

other markets, including the U.S. market, not only during the EC growth spurt but over the longer run.

EC officials, however, often argue that U.S. firms will excel in the competitive struggle. One EC publication puts it as follows:[5]

> U.S. businesses are well placed to exploit the benefits of a unified market. First of all, their subsidiaries incorporated in the Community will profit from the removal of barriers to the same extent as purely European companies. American companies are already used to operating in both a global and a large domestic marketplace, so may have less trouble adapting to the new environment than indigenous companies.
>
> U.S. exporters will find themselves selling into a single market with a generally uniform set of norms, standards, and testing and certification procedures. They will no longer have to face 12 different sets of requirements or intra-Community border controls. . . .
>
> In fact, many people of the Community are afraid that the main beneficiaries of the internal market could well prove to be the Japanese and American companies operating in Europe.

Progress in Completing the Market

It was in June 1985 that the EC Commission released its White Paper detailing a program for completing the internal market by the end of 1992. The undertaking is formidable even at the technical level, and at the political level has encountered opposition from many who would be affected adversely. What progress has been made?

A single quantitative measure is not feasible, but a crude idea of overall progress is conveyed by the percentage of White Paper subject areas that have been acted upon. As of January 30, 1989, the EC Commission had submitted proposals for more than four-fifths of the subjects covered in the White Paper, and the Council of Ministers—the EC's supreme decisionmaking body—had adopted more than two-fifths of the measures that will eventually be required. Areas in which little progress had been made include freeing the movement of people and reconciling the differences in indirect taxation and in plant and animal health regulation.[6]

Much skepticism exists that the EC nations will resolve all their differences—especially on sensitive matters such as taxation—so as to complete the internal market fully. Certainly it is most unlikely that all of the White Paper's program will be in effect by the end of 1992. But the endeavor should not be labeled a failure on those grounds alone. It has been said more than once that "1992 is a process, not an event." By the end of 1992, that process probably will have made substantial progress in integrating the European market.

Conclusion

Motivated largely by frustration with internal economic barriers and by a desire to gain in international economic stature, the EC is well embarked upon a massive effort to establish a Community-wide market free of restrictions over the movement of goods, services, persons, and capital. The potential gains to the EC from such market integration could amount to more than 6 percent of the Community's GDP, with much smaller gains for the rest of the world.

Despite some disturbing omens, it seems unlikely that the EC will transform itself into a protectionist "Fortress Europe" as it unifies its internal market. One deterrent is the threat of retaliation from the rest of the world. Another is the risk that the inefficiencies associated with such protectionism would offset the efficiencies to be reaped from internal market integration.

Viewed as a collectivity, the EC is the largest export market for the United States. Similarly, EC affiliates of U.S. multinational firms account for nearly half of the sales of all foreign affiliates of U.S. companies. The firms to benefit most from EC market integration will be those that are highly competitive within the EC and that have been encumbered by substantial cross-border and other costs and barriers associated with market fragmentation.

Barring a near miracle, the EC internal market will not be completed on schedule by the end of 1992. While there is no guarantee of eventual success, a delay of some years would mean little in such a grand undertaking.

[1] This is the classification used by Calingaert (1988, pp. 20–27).

[2] In a recent theoretical inquiry, Ian Wooton (1988, p. 537) concludes that the welfare of a customs union is enhanced by establishment of a common market as long as the common external tariff structure is set correctly.

[3] See U.S. Bureau of Economic Analysis, *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data*, 1985, p. 225, for local as well as total sales by majority-owned nonbank affiliates of nonbank U.S. parents for 1982.

[4] The same is true if exports are defined to include services as well as merchandise.

[5] "A Europe Without Borders by 1992: Answers to Some Questions," *European Community News*, No. 23/88 (September 15, 1988), p. 4.

[6] "E.C. Commission Evaluates Progress of 1992 Program," *European Community News*, No. 31/88 (November 10, 1988).

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